

IOWA SCHOOLS EMPLOYEE BENEFITS ASSOCIATION

FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

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IOWA SCHOOL BOARDS EMPLOYEE BENEFITS ASSOCIATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

For Fiscal Year Ended June 30, 2005

This narrative overview and analysis of the financial activities of the Iowa Schools Employee Benefits Association (ISEBA) is presented by ISEBA's management and is for the fiscal year ended June 30, 2005. Readers are encouraged to consider the information presented here in conjunction with ISEBA's financial statements, which follow this overview.

Financial Highlights

ISEBA's total net assets for fiscal year June 30, 2005 increased \$820,581 over June 30, 2004, mainly as a result of a change in estimate of unpaid claims under the partially self-insured plan which terminated on July 1, 2004. June 30, 2005 net assets (deficit) totaled \$(1,404,023). June 30, 2004 net assets (deficit) were \$(2,239,604).

Using this Annual Report

This discussion and analysis is intended to serve as an introduction to ISEBA's basic financial statements. ISEBA's basic financial statements consist of a series of financial statements. The statement of net assets, the statement of revenues, expenses and changes in net assets, and the statement of cash flows provide information about the activities of ISEBA and present a longer-term of ISEBA's finances. These basic financial statements also include the notes to the basic financial statements and explain some of the information in the statements and provide more detail.

Overview of the Financial Statements

Statement of net assets: The statement of net assets presents the assets, liabilities and net assets of ISEBA as of the end of the year. The statement of net assets is a point-in-time financial statement. The purpose of this statement is to present a fiscal snapshot of ISEBA to the readers of the financial statements. The statement of net assets includes year-end information concerning current assets that can reasonably expect to be collected or consumed with a year or less. Over time, readers of the financial statements are able to determine ISEBA's financial position by analyzing the increases and decreases in net assets. This statement is also a good source for readers to determine how much ISEBA owes to outside vendors and creditors. The statement also presents the available assets that can be used to satisfy those liabilities.

All of ISEBA's net assets are unrestricted and can be used to meet ISEBA's obligations.

	<u>2005</u>	<u>2004</u>
Current assets	\$ 6,022,071	\$ 6,787,172
Noncurrent assets	14,612	5,058,238
Total assets	<u>\$ 6,036,683</u>	<u>\$11,845,410</u>
Current liabilities:		
Unpaid claims	\$ 150,000	\$11,550,203
Advanced premiums	744,878	637,793
State premium assessment	746,938	1,444,853
Line of credit	5,275,000	-
Accounts payable	500,415	452,162
Accrued interest	23,475	-
Total current liabilities	<u>\$ 7,440,706</u>	<u>\$14,085,013</u>
Net assets (deficit), unrestricted	<u>\$(1,404,023)</u>	<u>\$(2,239,604)</u>
Total liabilities and net assets (deficit)	<u>\$ 6,036,683</u>	<u>\$11,845,410</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS
For Fiscal Year Ended June 30, 2005

Overview of the Financial Statements (Continued)

Statement of revenues, expenses and changes in net assets (deficit): Changes total net assets, as presented on that statement of net assets, are based on the activity presented in the statement of revenue, expenses and changes in net assets. The purpose of the statement is to present the revenue received by ISEBA, both operating and nonoperating, and the expenses paid by ISEBA, both operating and nonoperating, and any other revenues, expenses, gains and losses received or spent by ISEBA.

Operating revenues are received as premiums and commissions, and totaled \$64,695,963 of the \$64,726,615 total revenue. Operating expenses totaled \$65,143,980 and were expended for claims and administration. Nonoperating revenues consisted of interest income on cash accounts. Nonoperating expenses consisted of interest expense on the line of credit and amortization on the computer software.

	<u>2005</u>	<u>2004</u>
Operating revenue	\$ 64,695,963	\$108,932,506
Nonoperating revenue	<u>30,652</u>	<u>56,203</u>
Total revenue	<u>\$ 64,726,615</u>	<u>\$108,988,709</u>
Operating expenses	\$ 65,143,980	\$105,391,268
Nonoperating expenses	<u>\$ 258,283</u>	<u>\$ -</u>
Change in estimate	<u>\$ 1,511,229</u>	<u>\$ -</u>
Change in net assets	<u>\$ 835,581</u>	<u>\$ 3,597,441</u>
Net assets (deficit), unrestricted, beginning	<u>(2,239,604)</u>	<u>(5,837,045)</u>
Net assets (deficit), unrestricted, ending	<u>\$ (1,404,023)</u>	<u>\$ (2,239,604)</u>

Statement of cash flows: The final statement included in ISEBA's basic financial statements is the statement of cash flows. The statement of cash flows is an important tool in helping the users to assess an entity's ability to generate future net cash flows, its ability to meet its obligations as they come due, and its need for external financing. The statement of cash flows presents information related to cash inflows and outflows, summarized by operating and investment activities.

	<u>2005</u>	<u>2004</u>
Cash provided by (used in):		
Operating activities	\$ (8,116,518)	\$ (6,264,734)
Investing activities	13,117	56,203
Non-capital financing activities	<u>5,043,115</u>	<u>-</u>
Net (decrease) in cash	<u>\$ (3,060,286)</u>	<u>\$ (6,208,531)</u>
Cash, beginning of year	<u>4,028,115</u>	<u>10,236,646</u>
Cash, end of year	<u>\$ 967,829</u>	<u>\$ 4,028,115</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS

For Fiscal Year Ended June 30, 2005

Economic Factors

ISEBA served as a partially self-insured plan from July 1, 1999 to July 1, 2004. During fiscal year 2005, the plan was fully insured.

Health care inflation has been increasing at a double-digit pace annually. ISEBA's cost structure during the fiscal year was negatively impacted by having a high proportion of fixed administration expenses and a significant loss in the number of participants due to the switch from a partially self-insured plan to a fully-insured plan.

Contacting ISEBA's Financial Management

This financial report is designed to provide a general overview of ISEBA's finances, and to demonstrate ISEBA's accountability for the resources it receives. If you have questions about this report or need additional financial information, please contact the Iowa Schools Employee Benefits Association, 700 Second Avenue, Des Moines, Iowa 50309.

INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Iowa Schools Employee Benefits Association

We have audited the accompanying statement of changes in net assets available for benefits of Iowa Schools Employee Benefits Association (ISEBA) as of June 30, 2005, and the related statements of revenues, expenses and changes in net assets (deficit) available for benefits and cash flows for the year then ended. These financial statements are the responsibility of ISEBA's management. Our responsibility is to express an opinion on these financial statements based on our audit. The beginning balance of net assets (deficit) as of June 30, 2004, before the restatement described in Note 6, were audited by other auditors whose report dated May 18, 2005 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ISEBA as of June 30, 2005, and the changes in its financial position and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

We also audited the adjustments in Note 6 that were applied to restate the June 30, 2004 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 12, 2006, on our consideration of ISEBA's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis on pages i-iii is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

West Des Moines, Iowa
January 12, 2006

IOWA SCHOOLS EMPLOYEE BENEFITS ASSOCIATION

STATEMENT OF NET ASSETS

June 30, 2005

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$ 967,829
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RECEIVABLES

Premiums receivable	\$ 43,063
Premium assessment	3,108,719
Insurance settlement	1,840,000
Other receivables	62,460
Total receivables	<u>\$ 5,054,242</u>

Total current assets	<u>\$ 6,022,071</u>
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Computer software	\$ 17,535
Less accumulated amortization	2,923
	<u>\$ 14,612</u>

Total assets	<u><u>\$ 6,036,683</u></u>
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LIABILITIES AND NET DEFICIT

CURRENT LIABILITIES

Unpaid claims	\$ 150,000
Advanced premiums	744,878
State premium assessment	746,938
Line of credit	5,275,000
Accounts payable	500,415
Accrued interest	23,475

Total current liabilities	<u>\$ 7,440,706</u>
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NET ASSETS (DEFICIT), unrestricted	<u>\$ (1,404,023)</u>
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Total liabilities and net assets (deficit)	<u><u>\$ 6,036,683</u></u>
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See Notes to Financial Statements.

IOWA SCHOOLS EMPLOYEE BENEFITS ASSOCIATION

**STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS (DEFICIT)**

Year Ended June 30, 2005

OPERATING REVENUES

Premiums earned	\$ 64,346,461
Commission income	<u>349,502</u>
Net operating revenues	<u>\$ 64,695,963</u>

OPERATING EXPENSES

Premiums paid to insurance companies	\$ 61,950,142
Program administration and services:	
Claims administration-Principal Financial Group	\$ 713,410
Program administration-Morneau Sobeco	1,902,326
Management fees-IASB	120,000
Management fees-ISEA	<u>120,000</u>
Total program administration and services	<u>\$ 2,855,736</u>
General and administrative:	
Accounting	\$ 20,200
Professional fees	240,998
Office supplies	12,474
Board expense	7,264
Insurance	53,376
Marketing	<u>3,790</u>
Total general and administrative	<u>\$ 338,102</u>
Total operating expenses	<u>\$ 65,143,980</u>
Operating (loss)	<u>\$ (448,017)</u>

NON-OPERATING REVENUES (EXPENSES)

Amortization	\$ (2,923)
Interest expense	(255,360)
Interest income	<u>30,652</u>
Total non-operating revenues (expenses)	<u>\$ (227,631)</u>
Change in net assets (deficit) before change in estimate	\$ (675,648)
Change in estimate of unpaid claims	<u>1,511,229</u>
Change in net assets (deficit) after change in estimate	\$ 835,581
Net assets (deficit), unrestricted, beginning of year, as restated	<u>(2,239,604)</u>
Net assets (deficit), unrestricted, end of year	<u><u>\$ (1,404,023)</u></u>

See Notes to Financial Statements.

IOWA SCHOOLS EMPLOYEE BENEFITS ASSOCIATION

STATEMENT OF CASH FLOWS

Year Ended June 30, 2005

CASH FLOWS FROM OPERATING ACTIVITIES

Cash received from premiums	\$ 65,584,204
Cash received from commissions	287,042
Cash received for claim assessments	1,204,519
Cash received from reinsurance recoverable	505,335
Cash payments to insurance companies	(62,282,200)
Cash paid for claim assessments	(9,888,974)
Cash payments for state assessment	(697,916)
Cash payments to program and administration services	(2,538,601)
Cash payments for general and administrative	(289,927)
Net cash (used in) operating activities	<u>\$ (8,116,518)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Investment income	\$ 30,652
Cash payment for computer software	(17,535)
Net cash provided by investing activities	<u>\$ 13,117</u>

CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES

Cash received from line of credit	\$ 9,625,000
Principal payments on line of credit	(4,350,000)
Interest payments on line of credit	(231,885)
Net cash provided by non-capital financing activities	<u>\$ 5,043,115</u>

Reconciliation of operating (loss) to net cash (used in) operating activities:

Operating (loss)	\$ (448,017)
Adjustments to reconcile operating (loss) to net cash (used in) operating activities:	
Changes in assets and liabilities:	
Decrease in receivables	1,558,534
Decrease in assessment receivable	1,204,519
(Decrease) in unpaid claims	(9,888,974)
Increase in advanced premiums	107,084
(Decrease) in state assessment	(697,916)
Increase in accounts payable	48,252
Net cash (used in) operating activities	<u>\$ (8,116,518)</u>
Net (decrease) in cash and cash equivalents	<u>\$ (3,060,286)</u>
Cash and cash equivalents at beginning of year	<u>\$ 4,028,115</u>
Cash and cash equivalents at end of year	<u><u>\$ 967,829</u></u>

Non-cash investing, capital, and financing activities:

Change in unpaid claims estimate	\$ 1,511,229
Amortization	2,923
Total non-cash investing, capital, and financing activities	<u><u>\$ 1,514,152</u></u>

See Notes to Financial Statements.

IOWA SCHOOLS EMPLOYEE BENEFITS ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Business and Significant Accounting Policies

Nature of business:

Iowa Schools Employee Benefits Association (ISEBA) was formed July 1, 1999 under Chapter 28E of the Code of Iowa and provides insurance for medical, vision, life, dental and accidental death coverage to Iowa school districts and area education agencies. ISEBA operated a partially self-funded plan until July 1, 2004 at which time ISEBA became a fully-insured plan.

Significant accounting policies:

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as they apply to governmental entities. Pursuant to the Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Funds that Use Proprietary Fund Accounting*, ISEBA has elected not to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board issued after November 30, 1989.

Measurement focus and basis of accounting: The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Use of estimates: The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the recorded amounts of assets and liabilities and disclosure of contingent assets and liabilities as the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents: For purposes of statement of cash flows, ISEBA considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

Premium assessment: ISEBA assessed all participants for the run-out liability and financial shortages from the partially self-funded program.

State premium assessment: ISEBA was assessed by the Iowa Individual Health Benefit Reinsurance Association pursuant to Section 513C.10, Iowa Code. This assessment is currently under dispute by management.

Unpaid claims: Unpaid claims is a liability for reported and unreported incurred claims for the partially self-insured plan which terminated July 1, 2004. The unpaid claims liability represents the remaining estimated unpaid claims based upon prior claims experience and subsequent claim lag reports. Changes in estimates are reflected in change in estimate of unpaid claims in the statement of revenues, expenses and changes in net assets (deficit).

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Business and Significant Accounting Policies *(Continued)*

Significant accounting policies: *(Continued)*

Amortization: Amortization for financial reporting purposes is computed using the straight-line methods over the estimated useful service lives of the assets. For financial reporting purposes, the service life of the computer software is three years.

Premiums paid to insurance companies: Premiums paid to insurance companies consist of premiums for health, vision, life, dental and accidental death premiums paid by ISEBA on behalf of the participants.

Operating revenues and expenses: Operating revenues result from exchange transactions associated with the principle activity of ISEBA, the providing of insurance coverage. Operating expenses are defined as expenses directly related to, or incurred in support of, the providing of insurance coverage to participating members. Interest income, interest expense, and amortization are classified as nonoperating expenses and revenue.

Income taxes: ISEBA was formed under Chapter 28E of the Iowa Code and is tax-exempt as it is an instrumentality of the state of Iowa.

Note 2. Deposits

ISEBA's deposits as of June 30, 2005 were entirely covered by federal depository insurance, or collateralized by a multiple financial institution collateral pool in accordance with Chapter 12C, Code of Iowa. This Chapter provides for additional assessments against the depositories to ensure there will be no loss of public funds. As of June 30, 2005, the carrying amount of ISEBA's cash deposits were \$967,829.

Note 3. Line of Credit

ISEBA has a \$7,000,000 line of credit with a bank which expires March 31, 2006. Interest is paid at the annual LIBOR rate plus 260 basis points adjusted daily as the LIBOR rate adjusts. The interest rate at June 30, 2005 was 5.94 percent. The line of credit is secured by all of the assets of ISEBA. Borrowings on the line of credit are only to be used to pay run out claims from fiscal year 2004 in which the partially self-funded plan terminated. Outstanding borrowings on the line of credit totaled \$5,275,000 at June 30, 2005.

The Iowa Association of School Boards (the Association) has provided a limited guarantee on the line of credit and is limited to the principal amount of \$1,650,000, plus any interest which may be accrued on the indebtedness of the line of credit. Accrued interest on the line of credit was \$23,475 at June 30, 2005. If ISEBA fails to pay the line of credit, the Association would also be responsible for all costs, expenses, and fees (including reasonable attorneys' fees) paid or incurred by the bank at any time in attempting to enforce the guaranty.

NOTES TO FINANCIAL STATEMENTS

Note 4. Related Party Transactions

ISEBA has a support services agreement with the Iowa Association of School Boards, an affiliate. The agreement is subject to termination by either party upon six months written notice. During the year ended June 30, 2005, management fees of \$120,000 were incurred.

ISEBA also has a support services agreement with the Iowa State Education Association, an affiliate. The agreement is subject to termination by either party upon six months written notice. During the year ended June 30, 2005, management fees of \$120,000 were incurred.

ISEBA has contracted with Morneau Sobeco, Ltd. (Morneau) to provide services to ISEBA. The agreement calls for an annual fixed fee to be paid to Morneau in the amount of \$804,000 per annum, payable in equal monthly installments for consulting and service fees. The agreement also has variable charges per participant for administrative fees on billing and premium reconciliation transaction services and other miscellaneous charges. During the year ended June 30, 2005, variable fees totaling \$1,098,326 were incurred. Miscellaneous amounts due from Morneau as of June 30, 2005 were \$16,719 and administrative fees payable to Morneau as of June 30, 2005 was \$317,134.

ISEBA has a contact with Principal Financial Group (Principal) to provide services to ISEBA. The agreement calls for certain fees based upon a pre-established schedule as set forth in the agreement to process claims and perform other administrative functions for the self-funded plan which terminated July 1, 2004. During the year ended June 30, 2005, fees totaling \$713,410 were incurred. The amount due to ISEBA as of June 30, 2005 was \$31,929 for discounts received from providers.

Note 5. Significant Estimate

Unpaid claims balance is considered an estimate that is particularly susceptible to significant change as it relates to the determination of reported and unreported insured events. The unpaid claims balance is subject to change based upon management's evaluation of reported and unreported insured events. Because of the uncertainties associated with unpaid claims, it is reasonably possible that management's estimates of the unpaid claims balance may change in the near term.

ISEBA establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claims expenses under the partially self-insured plan which terminated on July 1, 2004. The following represents changes in those aggregate liabilities for ISEBA during the year ended June 30, 2005:

Unpaid claims, beginning of year, net of reinsurance	\$ 11,044,868
Incurred claims related to current year, net of reinsurance	-
Change in estimate of unpaid claims	(1,511,229)
Reinsurance received	505,335
Claims paid, net of reinsurance	<u>(9,888,974)</u>
Unpaid claims, end of year	<u>\$ 150,000</u>

NOTES TO FINANCIAL STATEMENTS

Note 5. Significant Estimate *(Continued)*

During the year ended June 30, 2005, management estimated the remaining unpaid claims at June 30, 2005 to be approximately \$150,000. Based upon this estimate, ISEBA adjusted its unpaid claim estimate by \$1,511,229. The change in estimate is shown as a separate line item in the statement of revenues, expenses, and changes in net assets (deficit) as a change in estimate of unpaid claims.

Note 6. Restatement

Adjustments were made to the beginning net asset (deficit) balance related to assessments made by the state of Iowa for fiscal years 2003 and 2004. During the year ended June 30, 2005, management determined the assessments from the state were not properly presented in prior year financial statements. The beginning net asset balance has been restated by increasing the beginning net assets (deficit) by \$1,444,855. The following shows the change in net assets (deficit):

Net assets (deficit) as previously reported	\$ (794,749)
Change from unrecorded state assessments not recorded in prior years	<u>(1,444,855)</u>
Net assets (deficit), as restated	<u><u>\$(2,239,604)</u></u>

Note 7. Subsequent Events

ISEBA was served with a copy of a petition at law filed in the Clarke County, Iowa District by approximately 78 Iowa school districts alleging damages as a result of the partially self-funded health program terminated by ISEBA July 1, 2004. Subsequent to June 30, 2005, the lawsuit was settled by reducing the premium assessment by one-half of the amount assessed against these school districts. In addition, ISEBA received \$40,000 net of deductible from its liability insurance carriers for settling the litigation. Therefore, the premium assessment against the schools was reduced by approximately \$1,930,000.

ISEBA also filed a lawsuit in Polk County, Iowa against Principal Life Insurance Company alleging that the premium calculation prepared for and used by ISEBA to assess the schools' premiums was not properly calculated. Subsequent to June 30, 2005, ISEBA settled with Principal Life Insurance Company and received approximately \$1,800,000 in settlement of this lawsuit.

The net effect of the lawsuits on the June 30, 2005 financial statements was a decrease in premiums paid to insurance companies and an increase in the change in net assets of approximately \$115,000.